

## Monthly Market Commentary

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The U.S. market was up 4.19% in August after a modest pullback in July. Some of the drivers of the stock market included monetary policy news from Europe as well as a number of generally positive economic news out of the U.S.

**Europe:** The ECB announced it was reducing several key lending rates and raising the amount it charges banks leaving reserve balances at the central bank. It also revealed that it would be purchasing some covered bonds and asset-based securities. The details on the new programs were sketchy as to timing and amount. Although these were significant and unexpected actions, the ECB did not make the full move to purchase government securities in the area (so-called quantitative easing, or QE). Indeed, by charter, it would be difficult if not impossible for the central bank to buy sovereign debt, a move Germany strongly opposes. In the short run, all of these moves could modestly help the European economy. However, our economists fail to see how moving interest rates that are already so near zero by small fractions is going to change much. Programs to encourage lending, to be implemented shortly, could help slightly more.

**Employment:** The August jobs report showed employment grew by a puny 142,000 workers compared with the 207,000 workers added on average for the prior 12 months. The figure was well below the consensus of 228,000 jobs and even below Morningstar economists' more modest forecast of 200,000 jobs. Our economists don't view these results as reflective of the current state of the economy and the August jobs report seems inconsistent with other improving labor market indicators. Year-over-year, three-month averaged employment data showed that the private sector employment continued to grow at 2.1%, which is the pace that is consistent with 2.0–2.5% full year GDP growth.

**Manufacturing:** An array of U.S. manufacturing indicators released in August has shown that the sector is doing incredibly well. Both industrial production and Markit PMI indicated strong growth. U.S. automakers, particularly, are showing signs of strength as both production and sales have risen to 12.85 and 17.50 million units annualized respectively. It is

important to note that while manufacturing typically reflects the state of the overall economy, its direct effects on GDP and employment are unfortunately limited, as it is now just a small part of the U.S. economy.

**Housing:** August was a strong month for the U.S. housing market as starts, permits, existing sales, and pending sales all exceeded expectations. Those great numbers combined with the moderating home price increases (slowing to 8.1% year over year growth in June, according to S&P/Case-Shiller Index) show that the housing market is poised for a health recovery. The slowdown in the price increases is, in particular, a positive development as slowly rising prices help to recover some of the underwater mortgages without drastically ruining affordability. Because of the rapid price increases we experienced throughout 2013, Morningstar economists expect that the price growth moderation will continue at least through the end of 2014.

**Retail sales:** Consumption is a very important part of the GDP report (about 70%) and often sets the tone for overall economic activity. Retail sales make up about a third of consumption. Excluding the auto industry, which is measured from manufacturers data (and not dealer retail sales), retail sales grew just 0.1% month to month after growth of 0.2% the previous month. Expectations were for growth to accelerate given better employment data. In fact, the consensus, excluding autos, was for growth of 0.4%. Therefore, Morningstar economists are a little suspicious of the July numbers. Weather was good, employment was good, and weekly chain-store sales had shown a marked improvement. Therefore, it is suspected that the July numbers will be revised or August numbers will appear to be unusually strong.